

Message Text

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TO SECSTATE WASHDC IMMEDIATE 8801
TREASURY DEPT WASHDC IMMEDIATE
INFO AMEMBASSY BONN
AMEMBASSY PARIS
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E.O. 11652: N/A
TAGS: EFIN. UK
SUBJECT: ECONOMIC PROSPECTS TO END 1977

1. WHAT FOLLOWS IS THE OFFICIAL HMT FORECAST OF ECONOMIC PERFORMANCE UNTIL THE END OF 1977.
QUOTE: THE FIRST COLUMN OF THE TABLE SHOWS THE "MAIN" FORECAST, WHICH IS CONSISTENT WITH THE PROSPECTS FOR THE CURRENT BALANCE, THE PUBLIC SECTOR BORROWING REQUIREMENT (PSBR) AND DOMESTIC CREDIT EXPANSION REFERRED TO IN THE CHANCELLOR'S STATEMENT AND THE LETTER OF INTENT. THE SECOND COLUMN SHOWS THE POSSIBLE CONSEQUENCES OF A BETTER PERFORMANCE BY INDUSTRY IN EXPORT MARKETS AND IN COMPETITION WITH IMPORTS. THE FORECASTS IN BOTH COLUMNS ASSUME THE CONTINUED SUCCESS OF PAY POLICY AND THE MAINTENANCE OF THE UK'S PRESENT COMPETITIVE POSITION RELATIVE TO OTHER INDUSTRIAL COUNTRIES.

AS A RESULT OF IMPROVED COMPETITIVENESS AND RESTRICTED DOMESTIC DEMAND, THE FORECAST SHOWS A CONTINUED SHIFT OF RESOURCES INTO EXPORTS AND IMPORT SAVING AND A MAJOR REVIVAL IN MANUFACTURING INVESTMENT. STOCKBUILDING IS ALSO LIKELY TO SHOW A FURTHER RECOVERY. BUT BECAUSE BOTH

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PERSONAL CONSUMPTION AND PUBLIC EXPENDITURE ON GOODS AND

SERVICES ARE LIKELY TO FALL, ONLY A MODEST GROWTH RATE IN GDP OF AROUND 2 PERCENT CAN BE EXPECTED DURING 1977.

THE FORECAST SHOWS STRONGLY DIVERGENT TRENDS WITHIN PRIVATE SECTOR INVESTMENT, WITH THE TOTAL REMAINING UNCHANGED DESPITE A VERY STRONG RECOVERY IN THE MANUFACTURING SECTOR. THE BUOYANCY OF MANUFACTURING INVESTMENT IS CONFIRMED BY SURVEY EVIDENCE AND SHOULD BE HELPED BY THE ADDITIONAL INCENTIVES AND BY THE COMPARATIVELY FAVOURABLE PROSPECTS FOR MANUFACTURING OUTPUT. BY COMPARISON WITH 2 PERCENT GROWTH IN TOTAL OUTPUT (GDP) DURING 1977 MANUFACTURING OUTPUT IS FORECAST TO RISE BY ABOUT 5-1/2 PERCENT. THE FALLS IN OTHER CATEGORIES OF PRIVATE INVESTMENT ARE LARGELY THE CONSEQUENCE OF UNUSUALLY HIGH FIGURES FOR INVESTMENT IN SHIPS AND NORTH SEA OIL INSTALLATIONS IN THE SECOND HALF OF 1976. A FALL IN PRIVATE SECTOR HOUSING INVESTMENT IS ALSO LIKELY.

BOTH BECAUSE OF THE IMPROVEMENT IN EXPORT VOLUMES RELATIVE TO IMPORTS AND BECAUSE OF THE INCREASING PRODUCTION OF NORTH SEA OIL, THE EXTERNAL CURRENT ACCOUNT IS LIKELY TO BE ON A STRONGLY IMPROVING TREND, THOUGH THE OFFICIAL FORECASTS SHOW A RATHER SLOWER IMPROVEMENT THAN SOME INDEPENDENT FORECASTS. A CONTINUING, THOUGH DECLINING, DEFICIT IS FORESEEN FOR 1977 WITH SURPLUS ACHIEVED IN 1978.

THE PACE AND SCALE OF THE BALANCE OF PAYMENTS IMPROVEMENT DEPENDS GREATLY ON THE GROWTH OF WORLD TRADE AND ON THE TERMS OF TRADE, BOTH OF WHICH ARE EXTREMELY DIFFICULT TO FORECAST.

THE FORECAST INCREASE IN RETAIL PRICES REFLECTS, TO A LARGE EXTENT, THE EFFECTS OF THE HIGHER IMPORT PRICES WHICH HAVE FOLLOWED FROM THIS YEAR'S DEPRECIATION OF STERLING AND RISE IN WORLD COMMODITY PRICES. BY THE SECOND HALF OF 1977, A MARKED SLOWING DOWN OF PRICE INCREASES CAN BE EXPECTED. IN THE FOURTH QUARTER OF 1977 THE INCREASE TO A YEAR EARLIER MIGHT BE AROUND 15 PERCENT AND THE CURRENT RATE OF INCREASE (AND HENCE THE PROSPECT FOR 1978) VERY SUBSTANTIALLY BELOW THIS FIGURE.

FINALLY, THE TABLE SHOWS THE FORECAST FOR THE PSBR IN THE CURRENT AND FOLLOWING FINANCIAL YEARS. THESE REFLECT THE POLICY MEASURES TAKEN AND THE FORECAST DEVELOP-

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MENT OF THE ECONOMY AS A WHOLE.

IN PRESENTING FORECASTS IT IS ALWAYS NECESSARY TO STRESS THE HIGH DEGREE OF UNCERTAINTY INVOLVED. WHILE VARIANTS CAN ILLUSTRATE SOME POSSIBLE ALTERNATIVE OUTCOMES THEY ARE NOT AN ADEQUATE ALTERNATIVE TO MORE SYSTEMATIC TREATMENT OF MARGINS OF ERROR. END QUOTE

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TABLE: ECONOMIC PROSPECTS FOR 1977

VARIANT WITH
STRONGER
MAIN FORECAST TRADE
PERFORMANCE

A. OUTPUT AND EXPENDITURE AT CON-
STANT PRICES

PERCENT CHANGES

2ND HALF 1976 TO 2ND HALF 1977

GROSS DOMESTIC PRODUCT (AT

FACTOR COST) 2 3

CONSUMERS' EXPENDITURE - 2 - 2

PUBLIC EXPENDITURE ON GOODS

AND SERVICES - 3 - 3

EXPORTS OF GOODS AND SERVICES 8-1/2 10-1/2

PRIVATE FIXED INVESTMENT -- - 1/2

OF WHICH MANUFACTURING

INVESTMENT 19-1/2 20-1/2

STOCKBUILDING (AS PERCENT OF GDP) 1-1/2 2

IMPORTS OF GOODS AND SERVICES 1-1/2 L/2

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MANUFACTURING PRODUCTION 5-1/2 7

B. BALANCE OF PAYMENTS ON CURRENT ACCOUNT

POUNDS BILLIONS (CURRENT PRICES)

1977 1ST HALF - 1 - 1

2ND HALF - L/2 0

C. PUBLIC SECTOR BORROWING REQUIREMENT

POUNDS BILLIONS (CURRENT PRICE))

FINANCIAL YEAR 1976-77 11 11

FINANCIAL YEAR 1977-78 8-1/2 8

D. RETAIL PRICE INDEX

PERCENT CHANGE

FOURTH QUARTER 1976 TO FOURTH

QUARTER 1977 15 15

IN ADDITION, THE FOLLOWING CAN BE DERIVED FROM PRESS

RELEASE FORECASTS FOR YEAR 1977 ON 1970 PRICES:

76 PERCENT 77 PERCENT

CONSUMER EXPENDITURE - .1 - 1

PUBLIC EXPENDITURE GOODS AND

SERVICES

CONSUMPTION 2.8 1.8

INVESTMENT 1.2 - 9.5

TOTAL 2.3 - 1.3

PRIVATE FIXED INVESTMENT - 3.5 1.8

EXPORTS OF GOODS AND SERVICES 5.6 8.3

INVENTORIES(1) (POUNDS MILLION) - 500 300

TOTAL FINAL EXPENDITURE 2.2 2.3

LESS IMPORTS OF GOODS AND SERVICES 6.3 4.2

LESS ADJUSTMENT TO FACTOR COST 1.1 - .6

GDP AT FACTOR COST(1) 1.3 2.2

GDP INDEX (1974 EQUALS 100) 1.3 2.1

(1) - COMPROMISE ESTIMATE OF GDP

ARMSTRONG

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